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### **Heinz Amendment to Chairman's Proposals**

#### **A. Cash or Deferred Arrangements (401(k)), Tax-Sheltered Annuities (403(b)), Employer Matching and Employee Contributions**

1. Index the \$7,000 cap on elective deferrals under cash or deferred arrangements and tax-sheltered annuities by reference to percentage increases in the social security taxable wage base.

2. With respect to the nondiscrimination rules for 401(k) plans, employer matching and employee contributions, (a) apply the present law nondiscrimination test applicable to 401(k) plans, and (b) modify the definition of highly compensated employee to conform to the definition used for purposes of coverage, nondiscrimination, and nondiscrimination rules for welfare benefits.

3. Modify the restriction on conditioning contributions and benefits (other than employer matching contributions) on an employee's elective deferrals under a cash or deferred arrangement to grandfather plans in existence on (date of committee action) if (a) under the defined benefit plan, benefits are contingent on the employee elective deferrals; (b) only benefits attributable to elective deferrals may offset defined benefit plan benefits; (c) there is a uniform defined benefit plan match of employee elective deferrals; (d) the defined benefit plan benefits match employee elective deferrals up to 4 percent of pay; (e) there is a minimum interest rate for annuitizing elective deferrals in calculating the offset; and (f) no matching contributions are provided for employee elective deferrals at levels lower than the elective deferrals to which the defined benefit plan benefits are related. In addition, for purposes of determining whether employer matching contributions under the qualified cash or deferred arrangement are provided on a nondiscriminatory basis, the employer's contributions under the defined benefit plan could be taken into account.

#### **B. Simplified Employee Pensions (SEPs)**

1. Exclude SEP contributions from employee's income (rather than providing for deduction on Form 1040)
2. Permit employers to make contributions on fiscal year basis
3. Permit coverage requirement (employees working



for employer three of last five years) to be applied on fiscal year basis

4. Raise de minimis employee exclusion from \$200 in wages to \$300, and index to wage base.

### C. Minimum Standards for Qualified Plans

#### 1. Coverage

a. Adopt the Chairman's Proposal, with the modifications listed below.

b. Provide an alternative test under which a plan (or plans) of an employer would be deemed to satisfy the revised coverage tests if (i) the plan (or plans) satisfies the present-law fair cross-section test, and (ii) the average benefit provided to employees who do not participate in the plan (or plans) that pass the present-law fair cross-section test, but not the proposed fair cross-section test, is at least 60 percent of the average benefit provided to employees who participate in the plan (or plans). The average benefit provided to employees would be tested for the current year or, at the election of the employer, for the current year and the last four years (or such lesser number than four that the employer elects). Such election could not be revoked without the consent of the Secretary of the Treasury.

c. For purposes of applying the fair cross-section test and the alternative test, permit excludable employees to be disregarded.

d. Provide special rules to accommodate acquisitions and dispositions of business units to provide a period of time after such acquisition or disposition (e.g., until the plan year beginning in the taxable year following the taxable year in which the acquisition or disposition occurs) during which the coverage rules are deemed to be satisfied if (i) the coverage rules were satisfied immediately prior to the acquisition or disposition and (ii) there is no significant change in the coverage under the plan other than the change on account of the acquisition or disposition.

#### 2. Minimum Participation Requirement

a. Modify the rule to require coverage of the lesser of 50 employees or 40 percent of all of an employer's nonexcludable employees to permit a plan to satisfy the fair cross-section coverage test.



### 3. Integration

a. Permit an employer to limit combined annual benefits attributable to the employer's contributions to social security and annual benefits under the employer's defined benefit pension plan to 100 percent of the employee's final pay (highest year of the last five).

#### D. Withdrawal of Benefits

##### 1. Withdrawals Before Age 59-1/2

a. Provide a limited (for employees other than 5-percent owners) exception from the 15 percent early withdrawal tax on distributions from qualified plans in the case of an unforeseen hardship, which consists of significant medical expenses or casualty losses (amounts in excess of 5 percent of adjusted gross income), or involuntary termination of employment after cessation of unemployment benefits.

b. Modify the proposal so that the 15 percent tax on distributions from qualified plans does not apply in the case of an early retirement, as defined under the plan, by an employee (other than a 5-percent owner) after age 55.

c. In lieu of the 15 percent tax, impose a 10 percent tax (in the case of employees other than 5-percent owners) on early withdrawals of employer matching contributions and earnings, which are attributable to after-tax employee contributions, and a 5-percent tax on early withdrawals of earnings attributable to investments in deferred annuities.

d. Require that employers offer terminating employees the option of a direct transfer (subject to the usual rules requiring spousal consent) of an employee's vested accrued benefits to an IRA or to another qualified plan. Such option would be available only if the employee supplies sufficient information to enable the employer to effect the transfer. Further, revise the notice of rollover treatment required under present law to include a statement that an employee's distribution may be subject to an additional 15-percent income tax if not rolled over to an IRA or to another qualified plan.

e. Modify qualifying annuity rules to enable substantially level distributions from defined contribution plans and IRAs to avoid the tax.

##### 2. Uniform Tax Treatment of Distributions



a. Modify the basis recovery rules for pre-annuity starting date distributions to provide for pro-rata recovery of amounts attributable to employee contributions (aggregating employee contributions, matching contributions, and earnings).

b. Continue to permit long-term capital gains treatment with respect to individuals who attained age 50 by January 1, 1986.

**E. 15 Percent Tax on Excess Distributions**

1. Delete the proposal to impose a 15-percent additional income tax on annual benefits that exceed the greater of (a) \$112,500 or (b) 1.25 times the dollar limit on annual benefits under a defined benefit pension plan.

**F. Unfunded Deferred Compensation Arrangements (Sect. 457)**

1. Modify co-ordination with other elective contributions to exclude CODAs maintained by rural electric cooperatives.

**G. Tax-Sheltered Annuities (Sect. 403(b))**

1. Modify special catch-up election for elective deferrals to raise the annual limit to 50% of the elective deferral limit and raise the lifetime limit to \$30,000.

**H. Life Insurance and Health Plan Nondiscrimination Rules**

1. Adopt the Chairman's Proposal, with the modifications listed below.

2. Provide an alternative test under which a plan (or plans) of an employer would be deemed to satisfy the coverage tests in the Chairman's proposal if (i) the plan (or plans) satisfies the present-law fair cross-section test, (ii) the average benefit provided to employees who do not participate in the plan (or plans) that pass the present-law fair cross-section test, but not the proposed fair cross-section test, is at least 60 percent of the average benefit provided to employees who participate in the plan (or plans) being tested, and (iii) at least 80 percent of the employer's nonhighly compensated employees are eligible to participate in a plan (or plans) of the employer that provides a benefit that is at least 40 percent of the average benefit provided to employees who participate in the plan (or plans) that pass the present-law fair cross-section test, but not the proposed test.



The average benefit provided to employees would be tested for the current year or, at the election of the employer, for the current year and the last four years (or such lesser number than four that the employer elects). Such election could not be revoked without the consent of the Secretary of the Treasury.

3. For purposes of applying the fair cross-section test and the alternative test, permit excludable employees to be disregarded.

4. Provide special rules to accommodate acquisitions and dispositions of business units to provide a period of time after such acquisition or disposition (e.g., until the plan year beginning in the taxable year following the taxable year in which the acquisition or disposition occurs) during which the coverage rules are deemed to be satisfied if (i) the coverage rules were satisfied immediately prior to the acquisition or disposition and (ii) there is no significant change in the coverage under the plan other than the change on account of the acquisition or disposition.

5. Clarify that the waiting period of up to one year of service is permitted for noncore benefits (i.e., dental, vision, psychiatric, orthodonture, cosmetic surgery). Permit the Secretary of the Treasury to expand the list of noncore benefits in regulations. Noncore benefits could be tested separately from core benefits under the coverage tests.

6. Provide that no more than 40 percent of the participants in a plan may be highly compensated employees, unless the plan is noncontributory and provides universal coverage of regular, full-time employees.

#### **I. Limits on Contributions and Benefits**

1. Modify special rule for reduction of dollar limits on benefits applicable to police, firefighters, and pilots to include correctional officers.

#### **J. Miscellaneous Modifications**

##### **1. Effective Dates**

a. Delay the effective date to plan years beginning after December 31, 1988, of (1) the new nondiscrimination rules for cash or deferred arrangements and the new rules on withdrawals, conditioned benefits, and service eligibility, (2) the new nondiscrimination rules for employer matching and employee contributions, (3) the new coverage rules, (4) the new minimum participation requirements, (5) the definition of includible compensation, and (6) the required benefit commencement rule.



## 2. Required Regulations

a. Require the IRS to issue final regulations on the proposals requiring substantial change of plan documents (e.g., nondiscrimination rules, coverage, integration) by January 31, 1988, in order to give employers time to make plan amendments before the effective date.